

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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KHAnkeny

date: August 7, 2002

to: Diana Ferrarin, Revenue Agent Manager
Nancy Gupton, Revenue Agent

from: Katherine Ankeny, Attorney

subject: **Drafting Forms 872 that Are Restricted to an S Corporation's
Research Credit**

This memorandum responds to your request for assistance at our July 10, 2002 meeting. This memorandum should not be cited as precedent.

ISSUE

How should Exam draft each individual shareholder's Form 872 to restrict an assessment to an adjustment of the S corporation's research credit?

CONCLUSION

In conformity with the guidelines stated in sections 25.6.22.8.12 and 25.6.22.8.15(5)(b) of the Internal Revenue Manual, the restriction on each individual shareholder's Form 872 should be drafted as follows:

(3) The amount of any deficiency assessment is to be limited to that resulting from any adjustment to the taxpayer's distributive share of the current year credit for increasing research activities of [REDACTED] Inc. (EIN [REDACTED]), including but not limited to the item reported on Form 3800, Part I, line 1e of the taxpayer's return, any consequential changes to other items based on such adjustment, and any amount resulting from statutory computation or recomputation based on such adjustment. "Adjustment" means any change, whether reported or not reported on the taxpayer's return, to the taxpayer's distributive share of the current year credit for increasing research activities of [REDACTED] Inc. "Consequential changes" mean any direct or indirect effect

to other items as the result of adjustments to the current year credit for increasing research activities of [REDACTED] Inc.

FACTS

In [REDACTED], [REDACTED] Inc. was an S Corporation. [REDACTED] and [REDACTED] (the "taxpayers") owned [REDACTED]% and [REDACTED]%, respectively.

Attached to its [REDACTED] Form 1120S, on Form 3800, Part I, line 1e, [REDACTED] Inc. claimed \$[REDACTED] as the current year credit for increasing research activities (the "research credit"). Attached to his [REDACTED] Form 1040, on the Form 3800, Part I, line 1e, [REDACTED] claimed \$[REDACTED] as his [REDACTED]% share of the research credit. Similarly, [REDACTED] claimed \$[REDACTED] as his [REDACTED]% share of the research credit.

In [REDACTED], [REDACTED] and [REDACTED] each signed a Form 872 (the "prior Form 872") for his [REDACTED] tax year, extending the period of limitation to [REDACTED]. The prior Forms 872 were restricted to [REDACTED] Inc.: "This consent is limited to adjustments arising from [REDACTED] [REDACTED], Inc., an S corporation in which the taxpayer was a shareholder."

Currently, [REDACTED] and [REDACTED] have requested that the Form 872 (the "current Form 872") for their [REDACTED] tax year be further restricted to [REDACTED] Inc.'s research credit, which they claimed on Form 3800, Part I, line 1e of their [REDACTED] Forms 1040. They have suggested the following restriction for the current Forms 872: "(3) This consent is limited to any research & experimentation credit adjustments arising from [REDACTED], Inc., an S corporation in which the taxpayer was a shareholder."

ANALYSIS

The Forms 872 should be obtained from [REDACTED] and [REDACTED] because the tax treatment of chapter S items is determined at the shareholder level for tax years beginning after December 31, 1996. Pub. L. No. 104-188, § 1307(c)(1) (repealing I.R.C. § 6241 (1982)).

Prior to [REDACTED], when the period for assessing any tax arising from [REDACTED] Inc. would expire under the prior Forms 872, the Secretary and the taxpayers may consent in writing to extend the period to assess that tax for an additional period of time. I.R.C. § 6501(c)(4)(A). The

taxpayers have the right to further restrict the extension to the research credit claimed by [REDACTED], Inc. I.R.C. § 6501(c)(4)(B).

We recommend that the current Forms 872 be drafted to conform to the guidelines stated in sections 25.6.22.8.12 and 25.6.22.8.15(5)(b) of the Internal Revenue Manual, as follows:

(3) The amount of any deficiency assessment is to be limited to that resulting from any adjustment to the taxpayer's distributive share of the current year credit for increasing research activities of [REDACTED], Inc. (EIN [REDACTED]), including but not limited to the item reported on Form 3800, Part I, line 1e of the taxpayer's return, any consequential changes to other items based on such adjustment, and any amount resulting from statutory computation or recomputation based on such adjustment. "Adjustment" means any change, whether reported or not reported on the taxpayer's return, to the taxpayer's distributive share of the current year credit for increasing research activities of [REDACTED], Inc. "Consequential changes" mean any direct or indirect effect to other items as the result of adjustments to the current year credit for increasing research activities of [REDACTED] Inc.

In your transmittal letter to the taxpayers, you should use Form Letter 907 (DO) (Rev. 8-2000). This letter summarizes a taxpayer's right to refuse to sign a consent or to limit a consent. Section 6501(c)(4)(B) requires that "[t]he Secretary shall notify the taxpayer of the taxpayer's right to refuse to extend the period of limitations, or to limit such extension to particular issues or to a particular period of time, on each occasion when the taxpayer is requested to provide such consent." Since you will be modifying the language that the taxpayers requested, you might also explain that we use the language recommended in the Internal Revenue Manual so that the Forms 872 for all taxpayers are consistent.

CASE DEVELOPMENT AND STRATEGY RECOMMENDATIONS

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Please call me (213.894.3027, ext. 155) if you have any questions.

This memorandum may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

Area Counsel
(Communications, Technology and
Media: Oakland)

By: _____
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